

## Message Text

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41

ORIGIN TRSY-04

INFO OCT-01 EUR-12 ISO-00 ERDA-05 AID-05 CEA-01 CIAE-00

CIEP-01 COME-00 DODE-00 EB-07 FEAE-00 FPC-01 H-02

INR-07 INT-05 L-03 NSAE-00 NSC-05 OMB-01 PM-04

USIA-06 SAM-01 OES-03 SP-02 SS-15 STR-04 NEA-10 AF-06

ARA-06 /117 R

DRAFTED BY TREAS/JMLISTER/WLMCCAMEY/OASIA

APPROVED BY EB/IFD/OMA:RJRYAN

TREAS:RSLIGHTON

TREAS:FLWIDMAN

CEA:HBJUNZ

FRB:SPIZER

----- 071475

R 120006Z SEP 75

FM SECSTATE WASHDC

TO USMISSION OECD PARIS

AMEMBASSY BRUSSELS

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E.O. 11652' N/A

TAGS: EFIN, ECON, OECD

SUBJECT: FURTHER U.S. COMMENTS ON DRAFT TWP PAPER ON QUOTE  
SOME ASPECTS OF THE ECONOMIC IMPACT OF HIGHER OIL PRICES  
ON OECD COUNTRIES UNQUOTE

REF: A. STATE 169397; B. DES/NI758 1ST REV; C. STATE  
155536

1. MISSION IS REQUESTED TO PASS TO SECRETARIAT U.S.  
SUGGESTIONS FOR DETAILED DRAFTING CHANGES TO REFDOC  
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CONTAINED PARA 2. SECRETARIAT MAY IF IT WISHES CIRCULATE  
SUGGESTED CHANGES TO TWP IN ADVANCE OF SEPTEMBER 24-25  
MEETING. BRUSSELS PLEASE PROVIDE COPY TO VAN YPERSELE.

2. USG APPRECIATES REVISIONS MADE TO INITIAL DRAFT WHICH MEET MANY OF OUR CONCERNS. OUR MAJOR REMAINING CONCERNS RELATE TO WHAT WE SEE AS A DOWNPLAYING OF THE LONGER RUN ADVERSE IMPACT OF HIGHER OIL PRICES ON GROWTH--A CONCERN WE BELIEVE MOST MEMBERS OF THE TWP SHARE--AND THE CONTINUED ASSERTION THAT QUOTE MONETARY UNCERTAINTIES UNQUOTE HAVE CONTRIBUTED TO INCREASINGLY RAPID TRANSMISSION OF INFLATION. THESE AND OTHER CONCERNS ARE ADDRESSED IN THE SPECIFIC DRAFTING SUGGESTIONS SET FORTH BELOW, KEYED TO THE PARAGRAPH NUMBERS IN DES/NI75-8 1ST

REVISION:

CHAIRMAN'S NOTE:

PARA 5. SEE COMMENT IN REF C. WE CONTINUE TO PREFER DELETION, BECAUSE OF IMPLICATION THAT OPEC HAS DONE OECD AREA A FAVOR BY FREEZING OIL PRICES. THERE ARE ALSO EXPLICIT DEFICIENCIES IN PARAGRAPH AS REVISED. GIVEN SHARP REDUCTION IN DEMAND COUPLED WITH MILD WEATHER, FREEZE SUPPORTED BY REDUCTION IN OUTPUT UNDOUBTEDLY PREVENTED MARKET FORCES FROM INDUCING PRICE DECLINE. ALSO CURRENCY APPRECIATION CANNOT MAKE A SIGNIFICANT ANTI-INFLATIONARY CONTRIBUTION TO THE OECD COUNTRIES AS A GROUP.

PARA 6. CURTAILMENT OF SUPPLIES (2ND SENTENCE) SEEMS UNAVOIDABLE IF PRICE RISE IS TO STICK. SUGGEST SUBSTITUTION OF QUOTE WOULD UNQUOTE FOR QUOTE COULD UNQUOTE. LAST SENTENCE THIS PARA MIGHT USEFULLY BE REVISED AS FOLLOWS:

QUOTE THE LESS INDUSTRIALIZED COUNTRIES, AND PARTICULARLY THE OIL EXPORTING COUNTRIES, SHOULD BE JUST AS CONCERNED WITH REDUCING INFLATIONARY PRESSURES IN THE INDUSTRIAL COUNTRIES AS THE LATTER ARE THEMSELVES, AND THEREFORE SHOULD BE AWARE THAT A NEW OIL PRICE HIKE WOULD BE A LIMITED OFFICIAL USE  
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DANGER TO THEM ALSO SINCE IT MIGHT START A NEW INFLATIONARY SPIRAL UNQUOTE.

PARA 8. THE POINT MADE WITH RESPECT TO QUOTE SOMETHING LESS THAN A TRIPLING OR QUADRUPLING UNQUOTE COULD BE TIGHTENED UP, PERHAPS BY POINTING OUT THAT EVEN A SMALL PERCENTAGE INCREASE NOW CAN BE VERY GREAT COMPARED TO THE PRE-OCTOBER 1973 OIL PRICE LEVEL.

PARA 10. SUBSTITUTE QUOTE MIGHT WELL UNQUOTE FOR QUOTE WOULD VIRTUALLY UNQUOTE IN LAST SENTENCE.

PARA 12. REVISE FIRST TWO SENTENCES TO READ QUOTE ...

DEPEND ON OIL MARKET DEVELOPMENTS. IF THE RELATIVE PRICE OF OIL DOES NOT DECLINE, A MAJOR PROBLEM OF RESOURCE ALLOCATION WILL PERSIST BEYOND THE PERIOD REQUIRED TO OVERCOME TRANSITIONAL DIFFICULTIES. THIS IS LARGELY ... UNQUOTE

ANNEX I

PARA 4. FIRST SENTENCE PROBABLY UNDERSTATES RELATIVE

ROLE PLAYED IN SOME COUNTRIES BY CONCERNS ABOUT BALANCE OF PAYMENTS, AS OPPOSED TO INFLATION, IN INDUCING MORE RESTRICTIVE DEMAND POLICIES. MORE IMPORTANTLY, WE BELIEVE THAT THE PARA MAY TREAT TOO LIGHTLY THE DIFFICULT AND CONTROVERSIAL SUBJECT OF CONSTRAINTS ON DEMAND MANAGEMENT IMPOSED BY HIGHER OIL PRICES. SUGGEST FOLLOWING LANGUAGE BE ADDED:

QUOTE THE CONSTRAINTS ON OECD DEMAND MANAGEMENT POLICIES WERE PARTICULARLY SEVERE BECAUSE OF THE TIMING OF THE PRICE INCREASE--COMING AT THE CREST OF A PERIOD OF RAPID EXPANSION OF DEMAND WHEN A CLIMATE OF UNUSUALLY HIGH PRICE EXPECTATIONS PREVAILED. CONSEQUENTLY, IT HAS NOT BEEN POLITICALLY FEASIBLE, OR ECONOMICALLY SOUND, FOR THE OECD COUNTRIES TO COMPENSATE FULLY FOR THE NET EFFECTS OF THE PRICE INCREASE ON AGGREGATE DEMAND.

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PARA 9. FIRST SENTENCE, IN ASSERTING THAT WORLD TRADE NOW HAS TO BE DOWNGRADED AS A SOURCE OF ECONOMIC GROWTH, STILL BOTHERS US. PREFER LANGUAGE SUGGESTED REF. C.

PARA 12. THE TREATMENT OF LONGER-RUN GROWTH CONSEQUENCES IS INADEQUATE. THE SO-CALLED QUOTE STRUCTURAL UNQUOTE OR MICRO-ECONOMIC EFFECTS OF HIGHER OIL PRICES WILL PERSIST OVER A LONG PERIOD OF TIME. THE MAGNITUDE OF THESE EFFECTS IS EXTREMELY DIFFICULT TO FORESEE, BUT IT IS SURELY DISINGENUOUS TO ARGUE, AS THE PRESENT DRAFT DOES, THAT WE SHOULD NOT WORRY ABOUT THESE EFFECTS SINCE RESOURCES WILL QUOTE ADAPT THEMSELVES TO THE NEW DEMAND STRUCTURE UNQUOTE IN THE LONG RUN. EXISTING CAPITAL GOODS ARE NOT FULLY ADAPTABLE TO NEW END USES. THE NEW PATTERN OF DEMAND MAY WELL CREATE A SUBSTANTIALLY DIFFERENT SET OF CAPITAL-LABOR REQUIREMENTS AND HENCE A DIFFERENT LONG-TERM RATE OF GROWTH COMPATIBLE WITH GIVEN SAVINGS HABITS. AND IN ANY CASE IT WILL RESULT IN A NON-TRIVIAL DESTRUCTION OF THE VALUE OF EXISTING CAPITAL. IN ADDITION TO THE ONCE-AND-FOR-ALL LOSS OF

OUTPUT ASSOCIATED WITH HIGHER OIL PRICES, WHICH IS NOT  
LIKELY TO BE MADE UP, THE STRUCTURAL ADJUSTMENT WILL  
REQUIRE A SUBSTANTIAL SHIFT OF RESOURCES FROM CONSUMPTION  
TO INVESTMENT DURING THE TRANSITION PERIOD IF THE LONG-  
RUN GROWTH RATE PRE-OIL PRICE INCREASES IS TO BE  
REGAINED--AND EVEN IF A SMOOTH SHIFT COULD BE ACCOMPLISHED,  
IT IS NOT CLEAR THAT THE PREVIOUS LONG-TERM GROWTH RATE  
CAN INDEED BE REGAINED.

THEREFORE SUGGEST DELETION FIFTH SENTENCE (BEGINNING  
QUOTE A PRIORITY UNQUOTE) AND REVISION LAST TWO SENTENCES  
AS FOLLOWS: QUOTE WHATEVER THE SIZE OF SUCH OUTPUT

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LOSSES IN THE SHORT OR MEDIUM TERM, IT CAN BE EXPECTED  
THAT LABOR AND CAPITAL SUPPLIES WILL ADAPT THEMSELVES TO  
THE NEW DEMAND STRUCTURE OVER THE LONG RUN. HOWEVER, TO  
THE EXTENT THE CAPITAL/LABOR REQUIREMENTS OF THE NEW  
DEMAND STRUCTURE PROVE SIGNIFICANTLY DIFFERENT FROM THE  
OLD, THERE MAY WELL BE A LONG-RUN DECELERATION IN GROWTH  
ON THIS ACCOUNT. UNQUOTE  
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PARA 13. ANOTHER LONGER-RUN PROBLEM OF RESOURCE  
ALLOCATION MIGHT ARISE FROM AN INCREASE IN EXPORTS  
PLANNED BY OPEC WHICH ARE LIKELY TO BE CONCENTRATED IN A  
FEW SECTORS (E.G., PETRO-CHEMICALS AND STEEL) COMPETITIVE  
WITH KEY SECTORS IN INDUSTRIAL ECONOMIES. ALSO, REVISE  
FIRST SENTENCE TO READ: QUOTE THE OIL PRICE INCREASE  
ALSO RAISES A MAJOR ... UNQUOTE

PARA 14. MOST OF PRICE INCREASE OCCURRED PRIOR TO AND  
DURING DELIVERY RESTRICTIONS. ALSO, BELIEVE EPC TOOK  
LESS DEFINITIVE POSITION ON APPROPRIATE DEMAND POLICIES  
THAN DESCRIBED HERE (WHICH WAS SECRETARIAT'S POSITION).

ANNEX II

PARA 2. WE MUST FIRMLY REQUEST DELETION OF UNPROVEN  
ASSERTION THAT QUOTE MONETARY UNCERTAINTIES CONTRIBUTED TO  
AN INCREASINGLY RAPID TRANSMISSION OF INFLATIONARY  
PRESSURES. UNQUOTE

PARA 4. SUGGEST SUBSTITUTION OF QUOTE HIGHLY SIGNIFICANT  
UNQUOTE FOR QUOTE CRUCIAL UNQUOTE IN FIRST SENTENCE. KISSINGER

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## Message Attributes

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